

Message Text

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PAGE 01 OTTAWA 02570 192316Z
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 PA-01 AGRE-00 /092 W
-----049773 202309Z /23

R 192303Z MAY 78
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC 7462
INFO AMCONSUL MONTREAL
ALL OTHER CONGENS IN CANADA POUCH

C O N F I D E N T I A L OTTAWA 02570

E.O. 11652:N/A
TAGS: EFIN, CA
SUBJECT: SALES TAX ISSUE: FEDS DIG IN

REF: A. MONTREAL 995; B. QUEBEC 165; C. OTTAWA 1945

1. SUMMARY. FEDERAL GOVERNMENT SUFFERING UNRELENTING
CRITICISM FROM POLITICAL OPPOSITION OVER DECISION TO GRANT
UNCONDITIONAL CREDIT TO QUEBEC TAXPAYERS AFTER PQ REFUSAL
TO ACCEPT GOC SALES TAX PACKAGE. WESTERN PREMIERS HAVE
ALSO REGISTERED COMPLAINTS. GOC CONSIDERS ITS DECISION
TO BE FAIR AND EFFECTIVELY FINAL. SALES TAX ISSUE CASTS
DOUBT ON VIABILITY OF "NEW ERA" IN FEDERAL/PROVINCIAL COL-
LABORATION LAUNCHED BY GOC AT FEBRUARY ECONOMIC SUMMIT.
END SUMMARY.

2. POLITICAL OPPOSITION HAS ATTACKED GOC IN PARLIAMENT
FOR ITS DECISION TO GRANT UNCONDITIONAL CREDIT TO QUEBEC
TAXPAYERS OF FUNDS (CDOLS 186 MILLION) LOOKING FOR A HOME
AFTER PQ REFUSAL TO EXPAND COVERAGE OF SALES TAX CUTS AT
FEDERAL GOVERNMENT'S EXPENSE. OPPOSITION HAS CHARGED
THAT: (A) OTHER PROVINCES WERE NOT OFFERED OPTION OF UN-
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 OTTAWA 02570 192316Z

CONDITIONAL TAX CREDITS--THUS, GOC DECISION CONSTITUTES
DIFFERENTIAL TREATMENT OF QUEBEC--AND (B) CREDIT WOULD NOT
BENEFIT LOW INCOME QUEBECERS WHO DO NOT PAY INCOME TAXES.
WESTERN PREMIERS HAVE COMPLAINED THAT QUEBEC IS AGAIN RE-
CEIVING SPECIAL TREATMENT. DECISION HAS ALSO CAUSED SOME
UNREST WITHIN LIBERAL PARTY CAUCUS.

3. PM TRUDEAU AND FINANCE MINISTER CHRETIEN HAVE INSISTED THAT SALES TAX PACKAGE AS ORIGINALLY PROPOSED IN APRIL 10 BUDGET WAS DESIGNED TO GIVE PROVINCES SOME "TAX ROOM." IN PROVINCES WHICH HAVE ACCEPTED GOC PROPOSAL, FEDERAL INCOME TAX WILL BE CUT AND PROVINCIAL INCOME TAXES WILL BE INCREASED BY AN EQUIVALENT AMOUNT WITH PROCEEDS BEING USED TO PARTIALLY FUND REDUCTION IN PROVINCIAL SALES TAXES. IN REDUCING FEDERAL TAXES IN QUEBEC, GOC WAS PROVIDING THE PROVINCIAL GOVERNMENT THE SAME "TAX ROOM" ACCORDED TO OTHER PROVINCES. GOC HAS NOT ADDRESSED CRITICISM THAT TAX CREDIT MISSES LOW INCOME GROUPS (WHICH DO NOT PAY INCOME TAXES) TAX CREDITS, NOTING ONLY THAT THE RICH HAVE BENEFITED FROM REDUCTION IN PROVINCIAL SALES TAXES ON SELECTED PRODUCTS.

4. COMMENT: OFFICIAL IN OFFICE OF DEPUTY FINANCE MINISTER SHOYAMA TOLD EMBOFF THAT DECISION TO OFFER DIRECT TAX CREDIT RESULTED PRIMARILY FROM ELIMINATION OF OTHER, LESS ATTRACTIVE OPTIONS. FOLLOWING PQ REJECTION OF INITIAL GOC OFFER TO PROVIDE CDOLS 226 MILLION TO PARTIALLY COVER COST OF ACROSS THE BOARD CUTS IN PROVINCIAL SALES TAX AND QUEBEC DECISION TO EFFECT DEEPER CUTS ON SELECTED PRODUCTS (REF C) GOC HAD OPTION OF (A) FINANCING SMALL PORTION (2 PERCENTAGE POINTS) OF QUEBEC'S SELECTED CUTS AT COST OF CDOLS 40 MILLION AND RETAINING THE RESIDUAL CDOLS 186 MILLION OR (B) SPENDING ENTIRE CDOLS 226 MILLION ON FUNDING OF

CONFIDENTIAL

PAGE 03 OTTAWA 02570 192316Z

QUEBEC'S SELECTED CUTS. POLITICAL PRESSURES (INCLUDING FROM WITHIN LIBERAL PARTY) PRECLUDED DENYING QUEBEC THE ADDITIONAL CDOLS 186 MILLION. HOWEVER, OTHER PROVINCES WOULD HAVE REACTED SHARPLY TO SELECTION OF OPTION (B) SINCE THEY HAD UNSUCCESSFULLY ADVANCED SIMILAR PROPOSALS DURING PRE-BUDGET CONSULTATIONS WITH GOC. THUS, GOC CHOSE DIRECT TAX CREDIT AS COMPROMISE FINANCIAL TRANSFER MECHANISM.

5. OFFICIAL INDICATED THAT GOC EXPECTED DECISION TO PRODUCE ADVERSE REACTION IN QUEBEC NATIONAL ASSEMBLY (REF B) AND TO EVOKE CHARGE BY POLITICAL OPPOSITION THAT QUEBEC WAS BEING TREATED DIFFERENTIALLY. OFFICIAL POINTED OUT, HOWEVER, THAT OPPOSITION HAD PREVIOUSLY FAVORED FEDERAL FUNDING OF SELECTED TAX CUTS IN QUEBEC AND HAD THEREFORE SUPPORTED CONCEPT OF SPECIAL TREATMENT. GOC ALSO EXPECTED COMPLAINTS FROM SOME OTHER PROVINCIAL PREMIERS, GIVEN THEIR POLITICAL (PC) AFFILIATION.

6. GOC ACKNOWLEDGED THAT PARIZEAU HAD EXPRESSED RESERVATIONS CONCERNING GOC SALES TAX PROPOSAL IN PRE-BUDGET DISCUSSIONS, BUT THAT ANNOUNCEMENT OF COUNTER-PROPOSAL TWO DAYS AFTER INTRODUCTION OF BUDGET WAS EVIDENCE THAT PQ

HAD NEGOTIATED IN BAD FAITH. IN GOC VIEW, PQ WAS NEVER INTERESTED IN REACHING AN AGREEMENT, BUT ONLY IN DEMONSTRATING THAT PRESENT FEDERAL/PROVINCIAL POLITICAL STRUCTURE CANNOT WORK.

7. GOC REMAINS OPEN TO FURTHER CONSULTATIONS ON ISSUE, BUT FEELS THAT PQ WILL NOT COME FORTH WITH A NEW FORMULA AND THAT LATEST FEDERAL PROPOSAL WILL THEREFORE CONSTITUTE A FINAL DECISION ON THE MATTER. END RESULT APPEARS TO BE THAT FEDERAL GOVERNMENT IS THE POLITICAL LOSER WHILE NET BENEFITS FOR QUEBEC TAXPAYERS ARE UNCERTAIN. ENDERS

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PUBLIC ATTITUDES, ECONOMIC PROGRAMS, TAXES
Control Number: n/a
Copy: SINGLE
Draft Date: 19 may 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978OTTAWA02570
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: DG ALTERED
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780213-0515
Format: TEL
From: OTTAWA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780540/aaaabhki.tel
Line Count: 126
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 173d8c9a-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 MONTREAL 995, 78 QUEBEC 165, 78 OTTAWA 1945
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 08 jul 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2637845
Secure: OPEN
Status: NATIVE
Subject: SALES TAX ISSUE: FEDS DIG IN
TAGS: EFIN, PINT, CA
To: STATE
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/173d8c9a-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014